The Commonwealth of Massachusetts

DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY

December 15, 2004

D.T.E. 04-91

Petition of Boston Gas Company d/b/a KeySpan Energy Delivery New England, pursuant to G.L. c. 164, § 94A, for approval of a Firm Vapor Service Agreement between Boston Gas Company d/b/a KeySpan Energy Delivery New England and Distrigas of Massachusetts LLC to meet peak demand requirements of its firm customers.

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Limited Participant

I. INTRODUCTION

On October 5, 2004, Boston Gas Company d/b/a KeySpan Energy Delivery New England ("Boston Gas" or "Company"), pursuant to G.L. c. 164, § 94A, submitted for approval by the Department of Telecommunications and Energy ("Department") a Firm Vapor Service Agreement ("FVS Agreement") between Boston Gas and Distrigas of Massachusetts LLC ("DOMAC"). The Company's petition was docketed as D.T.E. 04-91.

On November 10, 2004, pursuant to notice duly issued, the Department conducted a public hearing to afford interested persons the opportunity to comment on the Company's proposal. The Attorney General of the Commonwealth ("Attorney General") intervened as of right, pursuant to G.L. 12, § 11E, and the Department granted Bay State Gas Company's motion for limited participant status. Immediately following the public hearing, the Department held an evidentiary hearing. The Company presented the testimony of Elizabeth Danehy Arangio, director of gas supply planning for Boston Gas. The Company submitted a brief on November 16, 2004. The Attorney General submitted a brief on November 17, 2004. The evidentiary record consists of 22 exhibits and one record request with a confidential and redacted response.

II. DESCRIPTION OF THE FVS AGREEMENT

Boston Gas states that the proposed FVS Agreement would be effective for a ten-year period beginning November 1, 2004, through October 31, 2014. The Agreement is intended to provide vapor to replace the resource currently dispatched from the Company's propane facility in Everett, Massachusetts ("Everett propane facility") (Exh. EDA-1 (redacted) at 4).

According to Boston Gas, the Everett propane facility is no longer able to provide the reliable peaking service for which it was intended (Petition at 1; Exh. KeySpan-1 (redacted) at 6). Under the FVS Agreement, the Company may purchase up to 20,600 MMBtu of vaporized liquid natural gas ("LNG") on a daily basis with a total annual contract quantity not to exceed 61,800 MMBtu (Petition at 1; Exh. KeySpan-1 (redacted) at 2). It is a three-day peaking supply agreement (Exh. EDA-1 (redacted) at 4). The price to be paid by Boston Gas is a negotiated rate that consists of an annual call payment[1] and a variable commodity charge (Exhs. EDA-1 (redacted) at 4; KeySpan-1 (redacted) at 4).

The Company explains that the FVS Agreement is the result of a three-way transaction between Boston Gas, DOMAC and Prolerized New England Company ("Prolerized"), all of whom own adjoining properties in Everett, Massachusetts (Exh. EDA-1 (redacted) at 6). Seeking to expand its operations, Prolerized had previously approached Boston Gas about leasing the property in Everett on which the Boston Gas propane facility was located (id.; Tr. at 35, 38). DOMAC was seeking an easement across Prolerized's land which is adjacent to DOMAC's Everett LNG terminal (Tr. at 36-37). Boston Gas states that, in order to grant the easement to DOMAC, Prolerized needed to relocate a portion of its operation and thus sought to lease the adjacent Boston Gas property on which the Everett propane facility was located (Tr. at 38). Boston Gas further explains that it was simultaneously seeking a cost-

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[1] A call payment is a negotiated rate that reflects the value of ensuring that volumes of LNG are available for use as needed during the winter period (Exh. EDA-1 (redacted) at 7-8). It is a non-refundable payment to DOMAC (Exh. KeySpan-1 (redacted) at 4). In this case, the call payment is also referred to as a demand charge (Exhs. KeySpan-1 (confidential) at 4; EDA-2 (confidential)).

effective winter peaking LNG supply to replace the output from the aging Everett propane facility (Exh. EDA-1 (redacted) at 6). Thus, Boston Gas provided a long-term lease of the aforementioned property to Prolerized and conditioned it subject to regulatory approval of the FVS Agreement and the decommissioning and removal of the propane tanks from the Boston Gas property (Exh. AG -1-1 (redacted Lease Agreement) at 3; Company Brief at 5-6). Prolerized granted a license to DOMAC for use of the parcel of land owned by Prolerized adjacent to DOMAC's LNG facility and, as a result, DOMAC agreed to enter into the FVS Agreement with Boston Gas (AG-1-1 (redacted License Agreement) at 1-2; Exh. EDA-1 (redacted) at 6-7).

III. POSITION OF THE PARTIES

A. The Company

The Company states that the FVS Agreement is consistent with its most recent long range forecast and requirements plan ("Supply Plan") approved in 2003. D.T.E. 01-105. The Company explains that the Everett propane facility was included in the Supply Plan as an expected available resource to meet sendout requirements (Exh. EDA-1 (redacted) at 6). The purchase of the LNG supply from DOMAC, which is negotiated in the FVS Agreement, will replace the supply of propane which was included in the Supply Plan as a resource to be provided by the Everett propane facility (id. at 4). The Company contends that the FVS Agreement will allow the Company to replace all the volumes from the Everett propane facility and thus the Supply Plan will remain intact (id. at 5-6).

The Company asserts that the unique set of circumstances existing between the Company, DOMAC and Prolerized resulted in the three-way negotiations which ultimately motivated DOMAC to enter into a propane replacement contract with Boston Gas at a price otherwise unavailable in the market (id. at 6-7). Consequently, Boston Gas did not solicit competitive bids from other suppliers (id.). The Company states that its only realistic alternative to the FVS Agreement was to invest in an upgrade of the Everett propane facility and forego the lease opportunity with Prolerized (id. at 7).

In asserting that the proposed contract was obtained at the least cost, Boston Gas relied upon an economic analysis of the cost of the FVS Agreement as compared to the cost to upgrade its Everett propane facility (Exhs. EDA-1 (redacted) at 7-8; EDA-2 (confidential); RR-DTE-1(a); Company Brief at 6). The Company contends that the call payment over the life of the contract costs less compared to the cost of upgrading and maintaining the Everett plant to reliably meet design sendout requirements over the next ten years (Exh. EDA-1 (redacted) at 8; Exh. EDA-2 (confidential)). As additional protection for the Company, the call payment may not exceed the Call Payment Cap in DOMAC's Federal Energy Regulatory Commission ("FERC") approved rate schedule FLSS,[2] and the average commodity rate over the contract term is capped at the average of DOMAC's FERC-approved rate schedule FVSS over the contract term (Exh. EDA-1 (redacted) at 8). Carrying costs associated with the

2 To the extent that the annual call payment cap exceeds the applicable call payment cap, DOMAC will refund such excess with interest, if any, pursuant to FERC regulations (Exh. KeySpan-1 (redacted) at 4).

physical storage of propane also are avoided as the LNG vapor delivered from the DOMAC facility is nominated and delivered only as needed and does not require physical storage (id.).

The Company states an added benefit of the FVS Agreement is that it will obviate the need for the aging propane facility which, although grandfathered, is not built in accordance with current industry codes (Exh. EDA-1 (redacted) at 8). Everett city officials, including the Fire Chief, have expressed security concerns regarding the present configuration of the propane facility (id.). Specifically, they have expressed a desire to either have the Everett propane facility reconfigured by burying the existing above-ground vertical tanks or to have the plant decommissioned (id.). The facility's close proximity to the DOMAC LNG facilities and the shipping route has resulted in periodic increased security costs each time the Office of Homeland Security raises the terror threat alert to code Orange or above, potential costs avoided if the plant is decommissioned (id. at 9). Another benefit is that the close proximity of the Company's local distribution system to the interconnection with DOMAC allows the Company to maintain system pressures while meeting the supply needs, therefore making DOMAC a valuable alternative resource option to the interstate pipelines serving the area (Tr. at 29-30; Exh. EDA-1 (redacted) at 9).

The Company states that the FVS Agreement will replace a fixed production asset[3] (Company Brief at 7-8). Absent the Company's proposed treatment of costs and revenues associated with the FVS Agreement, the Company recognizes that the short-term impact to

[3] The costs of the fixed propane facility were determined in the Company's last rate case. Boston Gas Company d/b/a KeySpan Energy Delivery New England, D.T.E. 03-40, at 371-372 (2003).

firm customers would be an increase in overall rates due to the increase in the GAF (id. at 8.). In order to prevent this short-term increase in overall rates, the Company proposes, in this instance, to book the demand charge component of the FVS Agreement as a production and storage cost rather than flow those costs through the GAF (id.). The Company would maintain this accounting treatment until the expiration of the FVS Agreement or the Company's next base rate proceeding, whichever first occurs, thus avoiding a short-term net increase in customer rates (id.). The Company proposes to retain the lease revenues received from Prolerized until its next base rate proceeding in accordance with normal ratemaking practice (Company Brief at 8, citing Exh. AG-1-9). Thereafter, the lease revenues would be credited as a benefit to the customers (id.).

B. Attorney General

The Attorney General contends that the Company did not issue a Request for Proposals ("RFP") for the proposed propane facility replacement resource and failed to provide evidence that the substitution of the DOMAC peaking resource for the propane resource would result in the least cost to customers (Attorney General Brief at 3). The Attorney General argues that the analysis prepared by the Company shows that the DOMAC arrangement costs the Company more than the propane facility upgrade and continuous operation (id.) The Attorney General further asserts that the benefit to the Company is due solely to the lease payments to be paid by Prolerized (id.).

The Attorney General also argues that the Company's analysis does not accurately reflect costs to customers and does not produce a least cost supply option since customers will continue to pay more than $261,000 annually for the decommissioned propane facility in addition to paying the monthly demand charges under the FVS Agreement (Attorney General Brief at 4). The Attorney General contends that the Company failed to provide both an analysis of alternatives and an analysis showing customer costs and benefits of the proposal, aside from the Company's cash flow related to upgrading and maintaining the Everett propane facility (id. at 4, citing Exh. EDA-2). Lastly, the Attorney General claims that the Company failed to provide estimates of potential costs to customers in the event the LNG supply was unavailable due to security or other adverse conditions (id. at 4).

The Attorney General asserts that allowing the Company to recover both the current level of production and storage costs and the DOMAC demand costs would not result in just and reasonable least cost rates (id. at 4). The Attorney General recommends that the Company be required to either: 1) recover through the GAF the same level of costs that would be collected under the Everett propane facility operation; or 2) at a minimum, credit the Prolerized-related revenues and reimbursements to the Company's GAF in order to mitigate the cost of the DOMAC demand charges (id.). Additionally, the Attorney General suggests that for ratemaking purposes, the Prolerized lease be treated as part of the gas supply package (id.).

IV. STANDARD OF REVIEW

In evaluating a gas utility's resource options for the acquisition of commodity resources as well as for the acquisition of capacity under G.L. c. 164, § 94A ("Section 94A"), the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). In order to demonstrate that the proposed acquisition of a resource that provides commodity and/or incremental resources is consistent with the public interest, a Local Distribution Company ("LDC") must show that the acquisition (1) is consistent with the company's portfolio objectives and (2) compares favorably to the range of alternative options reasonably available to the company and its customers, including releasing capacity to customers migrating to transportation, at the time of the acquisition or contract negotiation. Id.

In establishing that a resource is consistent with the company's portfolio objectives, the company may refer to the portfolio objectives established in a recently approved forecast and requirements plan or in a recent review of supply contracts under Section 94A, or may describe its objectives in the filing accompanying the resource proposal. Id. In comparing the proposed resource acquisition to current market offerings, the Department examines relevant price and non-price attributes of each contract to ensure a contribution to the strength of the overall supply portfolio. Id. at 28. As part of the review of price and non-price attributes, the Department considers whether the pricing terms are competitive with those of the broad range of capacity, storage, and commodity options that were available to the LDC at the time of the acquisition, as well as those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives, including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29. In making these determinations, the Department considers whether the LDC used a competitive solicitation process that was fair, open and transparent. The

Berkshire Gas Company, D.T.E. 02-56, at 9; Bay State Gas Company, D.T.E. 02-52, at 8 (2002); KeySpan Energy Delivery New England , D.T.E. 02-54, at 9 (2002); The Berkshire Gas Company, D.T.E. 02-19, at 11 (2002).

V. ANALYSIS AND FINDINGS

The Department has found the use of propane and LNG resources to meet seasonal needs in excess of pipeline entitlements to be reasonable. Boston Gas Company, D.P.U./D.T.E. 97-81 at 49 (2000). In determining whether or not the acquisition of the FVS Agreement is consistent with the Company's portfolio objectives, we turn to the Company's most recently approved supply plan. In D.T.E. 01-105, the Everett propane facility is included as an available resource to meet peak sendout requirement and features a maximum output availability of 40,000 MMBtu/day[4] and maximum storage capacity of 720,000 gallons.[5] Keyspan Energy Delivery New England, D.T.E. 01-105, at 112 (2003). The propane facility's capacity of 720,000 gallons of propane translates into approximately 63,000 MMBtus (Exh. Keyspan-1 (redacted) at 5). Therefore, its expected maximum output of 20,000 MMBtus/day equates into three days' usage (id.). In effect, the FVS Agreement is also a three-day peaking supply agreement, as the Company may purchase up to 20,600 MMBtu of

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4 The Company notes that Keyspan determined a maximum output of 20,000 MMBtu/day to be sufficient to reliably meet design day sendout requirements going into the 2003/2004 peak season (Exh. Keyspan-1 (redacted) at 5). Thus, while negotiating with DOMAC, the Company sought to replace the 20,000 MMBtus/day (id.).

5 D.T.E. 01-105 states that the maximum storage capacity of the propane facility is 720,000 MMBtus. However, the maximum storage capacity should have been listed as 720,000 gallons (Exh. Keyspan-1 (redacted) at 5).

vaporized LNG on a daily basis with the total annual contract quantity not to exceed 61,800 MMBtus (Exh. Keyspan-1 (redacted) at 4). The FVS Agreement is intended to be used in a fashion identical to that of the Everett propane facility and delivers a nearly equal amount of supply on a daily basis. Consequently, the Department finds that the FVS Agreement effectively replaces the function provided by the Everett propane facility and is therefore consistent with the Company's portfolio objectives.

While the Department acknowledges the Attorney General's concern that the Company did not conduct an RFP when reviewing replacement resources, the Department notes the unique circumstances surrounding the acquisition of the FVS Agreement. The failure of the Everett propane facility to dispatch volumes during a period of extreme weather conditions in January of 2004 deprived the Company of a planned peaking resource[6] (Exh. AG 1-7). The Company therefore required a replacement resource in place for the upcoming 2004-2005 winter period. The record indicates that the Company's only options were to acquire city gate delivered service, invest in an upgrade of the Everett plant, or negotiate an LNG contract with DOMAC (Exh. EDA-1 (redacted) at 7, Tr. at 39). The Company explained that city gate service, in addition to being substantially more expensive, would introduce operational complications as the Company would have to accept the service in a location other than Everett

6 In order to move the propane volumes into the distribution system, the operating system pressure needs to be fifteen pounds or less (Exh. AG-1-7). Historically, the Company has been able to operate its distribution system in the Everett area at fifteen pounds or less when there was a need for propane (id.). However, given the loads experienced in January 2004, the system pressure could not be reduced to fifteen pounds or less without jeopardizing reliability to customers (id.).

and then determine how to move the volumes across the distribution system to the area where the volumes are needed (Tr. at 39).

The record also indicates that upgrades to the Everett propane facility could not have been completed prior to the start of the winter period (Tr. at 38-39). Furthermore, the Company's estimated cost to upgrade the boiler and security at the Everett propane facility, as reported in Exhibit EDA-2 (redacted), only accounts for the pending changes to security standards at the state and federal level (Tr. at 29-30). Any additional costs stemming from burying the above-ground vertical tanks would increase the cost associated with the option of reconfiguring the existing propane facility (Tr. at 29-30).

The Department also recognizes the significance of DOMAC's proximity to the Company's distribution facilities in maintaining system integrity. As DOMAC's interconnection with the Company's distribution system is within a few hundred feet of the Everett propane facility, the proposed FVS Agreement will provide nearly identical levels of pressure directly to the service territory in need of those resources and would not preclude the Company from using the volumes available as a means of balancing system pressures (Tr. at 29-30). Consequently, having reviewed the limited options available to the Company, the Department finds that the FVS Agreement compares favorably to the range of alternatives reasonably available to the Company and its customers.

We do not agree with the Attorney General's argument that the FVS Agreement does not represent the least cost supply option. The economic analysis submitted by the Company in response to Department Record Request DTE-1, combined with the Company's proposal regarding the allocation of costs, demonstrates that the FVS Agreement is the least cost alternative (RR-DTE-1(a)). The Company performed a ratepayer-specific benefit analysis while comparing the costs of the FVS Agreement with the costs of upgrading the Everett propane facility (id.). The analysis identified a net benefit to ratepayers over the twenty-year period associated with the Company's proposed FVS Agreement (id.). In addition, the variable commodity cost of the FVS Agreement is based on a NYMEX propane price index which, according to the Company, is comparable to the current propane commodity cost recovered through the GAF for the sendout for the Everett propane facility (Tr. at 21; Exh. EDA-1 (confidential) at 4).

We now address the Attorney General's concern regarding the Company's failure to provide estimates of potential costs to customers in the event that DOMAC's LNG supply was disrupted by security concerns or other adverse conditions. We find these concerns to be unfounded, as the Department does not review alternative options when a Company acquires capacity or commodity contracts. Alternative plans for replacement resources in the event that contracts cannot be executed are evaluated during review of a Company's forecast and supply plan. Berkshire Gas Company, D.T.E. 02-17, at 40 (2003). As we noted above, the proposed contract is consistent with the Company's approved forecast and supply plan. As such, the Company was not required to address yet another alternative plan in this filing.

With regard to the Attorney General's suggested alternative ratemaking treatments, the Department points to the Company's ratemaking treatment as proposed in the Company's Brief (Company Brief at 7-8). In the Company's filing, Boston Gas made no specific proposal regarding the rate treatment of the costs and revenues associated with the FVS Agreement and the related lease of the Everett property to Prolerized (Exh. AG 1-9, Company Brief at 7). However, as the costs of the decommissioned Everett propane facility would continue to be recovered through the Company's current base rates, the Company acknowledged that the recovery of costs associated with the FVS Agreement through the Company's GAF would result in an increase in overall rates for firm customers in the short term (Company Brief at 7-8). In order to hold customers harmless in the near term, the Company, in this particular instance, agreed to book the demand charge component of the FVS Agreement as a production and storage cost rather than flowing those charges through the GAF (id. at 8). The Company will retain the lease revenues associated with the Prolerized agreement until the Company's next base rate proceeding, after which the lease revenues would be credited as a benefit to the customers (Exh. AG-1-9, Company Brief at 8). This accounting treatment would be maintained until the earlier of the expiration of the FVS Agreement or the Company's next rate case proceeding (Company Brief at 8). In addition, this accounting treatment appropriately recognizes the Company's ability to utilize the FVS Agreement volumes to balance system pressures in the same manner that it could historically utilize the Everett propane volumes (id.). Because the Company will not seek recovery of the demand charges associated with the FVS Agreement through the GAF, customers will not experience an increase in rates. The Department finds the Company's ratemaking treatment to be reasonable because firm customers will be held harmless.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That the Firm Vapor Service Agreement between Boston Gas Company and Distrigas of Massachusetts LLC for a long-term supply contract to meet peak demand requirements of Boston Gas Company customers, filed on October 5, 2004, is hereby approved, subject to the following conditions:

1. Boston Gas Company shall book the demand charge component of the FVS Agreement as a production and storage cost rather than through the GAF, said accounting treatment to be maintained until the expiration of the FVS Agreement or the Company's next rate case proceeding, whichever first occurs; and

2. Boston Gas Company may retain the lease revenues received from Prolerized until its next rate case proceeding, at which point the Company must credit the Prolerized lease revenues to the customers in accordance with normal ratemaking practice.

FURTHER ORDERED: That Boston Gas Company shall comply with all other directives contained in this Order.

By Order of the Department

__________/s/_________________
Paul G. Afonso, Chairman

__________/s/__________________
James Connelly, Commissioner

__________/s/__________________
W. Robert Keating, Commissioner

__________/s/___________________
Eugene J. Sullivan, Jr., Commissioner

__________/s/___________________
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).